

March 12, 2004



Financial Management

Early Payment of Invoices by the Defense Finance and Accounting Service Columbus (D-2004-058)

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Acronyms

| | |
|--------|---|
| ACO | Administrative Contracting Officer |
| CFR | Code of Federal Regulations |
| DFAS | Defense Finance and Accounting Service |
| FMR | Financial Management Regulations |
| MOCAS | Mechanization of Contract Administration Services |
| OMB | Office of Management and Budget |
| U.S.C. | United States Code |



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

March 12, 2004

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE
(COMPTROLLER)/DEPUTY CHIEF FINANCIAL OFFICER
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE COLUMBUS, CONTRACT PAY SERVICES

SUBJECT: Report on Early Payment of Invoices by the Defense Finance and Accounting
Service Columbus (Report No. D-2004-058)

We are providing this report for review and comment. We considered management comments on a draft of this report in preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. The Defense Finance and Accounting Service comments were partially responsive. We request additional comments on Recommendation A.1. and A.3. by April 12, 2004.

If possible, please send management comments in electronic format (Adobe Acrobat file only) to Audcolu@dodig.osd.mil. Copies of the management comments must contain the actual signature of the authorizing official. We cannot accept the / Signed / symbol in place of the actual signature. If you arrange to send classified comments electronically, they must be sent over the SECRET Internet Protocol Router Network (SIPRNET).

The team members are listed on the back cover.

A handwritten signature in black ink, reading "Paul J. Granetto", is positioned above the typed name.

Paul J. Granetto, C.P.A.
Director
Defense Financial Auditing
Service

Office of the Inspector General of the Department of Defense

Report No. D-2004-058

March 12, 2004

(Project No. D2003FJ-0062)

Early Payment of Invoices by the Defense Finance and Accounting Service Columbus

Executive Summary

Who Should Read This Report and Why? Civil service and uniformed personnel responsible for processing contractor payments in accordance with the Prompt Payment Act should read this report. The report discusses paying contractors on time, and the issues associated with making payments prematurely.

Background. This audit was conducted in response to allegations to the Defense Hotline that the Defense Finance and Accounting Service Columbus was not paying invoices in accordance with the Prompt Payment Act. The complaint also alleged that Lockheed Martin, Northrop Grumman, and Raytheon were given preferential treatment in the form of early payment of their invoices because of their size and influence. According to the Defense Finance and Accounting Service Columbus, the Contract Pay Product Line payments in FY 2001 were \$87 billion.

Results. There was insufficient evidence to substantiate the allegation that the Defense Finance and Accounting Service Columbus made early payments directly resulting from contractor-provided Hot Lists or gave preferential treatment to the three contractors named in the allegation. However, from January 2002 through January 2003, the Defense Finance and Accounting Service Columbus regularly paid invoices from the three contractors in the Hotline allegation, as well as other DoD contractors, earlier than allowed by the Prompt Payment Act. The Defense Finance and Accounting Service Columbus paid 108 invoices totaling \$300 million from the three Hotline contractors, and an additional 6,691 invoices totaling \$1.3 billion to other DoD contractors, more than 7 days prior to the due date. Because the Defense Finance and Accounting Service Columbus did not effectively adhere to the cash management requirements of the Prompt Payment Act there was a potential cost to the U.S. Treasury of about \$1.5 million in lost interest.

To improve cash management, the Defense Finance and Accounting Service Columbus needed to establish procedures to prevent the invoices it manually processes from being paid before the Prompt Payment Act allows them to be paid. (See the Finding section of the report for the detailed recommendations.)

Management Comments and Audit Response. The Director, Commercial Pay Services, concurred with the report recommendations. She indicated that it will not be possible to program the Mechanization of Contract Administration Services System to bypass only specific edits, while adhering to others, until the system is redesigned. She indicated that additional manual processes would be implemented to ensure that force-thru payments are proper, and waivers of cash management are properly authorized. The Director also stated that the Defense Finance and Accounting Service Columbus will

instruct the Defense Enterprise Computing Center to process invoices for which funds are due to be cancelled within 10 days of year-end. She revised policy and programs to prevent early release of payment without supervisory approval and documentation, and she revised the management control program for entitlements to include monthly reviews of force-thru invoices for validity and compliance with policy. The Director's comments regarding the redesign of the payment system were partially responsive. We believe that until the system is redesigned, the added manual controls will help prevent unnecessary force-thru payments, and ensure that cash management waivers are properly authorized and approved. However, the Director's comments did not specifically identify any interim procedures that would ensure that force-thru invoices are held until at least 7 days prior to the payment due date, and not paid early. Additionally, a monthly review of cash management waivers for appropriateness may not detect early payments that are made without the use of a waiver. We request that the Director, Commercial Pay Services, provide additional comments by April 12, 2004. See the Finding section for a summary of the management comments and the Management Comments section for the complete text of those comments.

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Background

On October 29, 2002, the Defense Hotline received a complaint that the Defense Finance and Accounting Service (DFAS) Columbus was not paying invoices in accordance with the Prompt Payment Act. The complaint alleged DFAS Columbus made payments to Lockheed Martin, Northrop Grumman, and Raytheon earlier than allowable under the Prompt Payment Act. Also, the complainant alleged payments were made early to the three contractors because of their size and their political influence.

Prompt Payment Act. The Prompt Payment Act of 1998, section 3903, title 31, United States Code (31 U.S.C. 3903), requires a payment 30 days after an invoice is received, or by the payment date established in the contract. The Act requires agencies to effectively manage invoices, and allows an agency to make payment up to 7 days prior to the required payment date, or earlier, as determined by the agency on a case-by-case basis. If an invoice is determined to be improper, and is returned to the contractor after 7 days, the period of time before payment is due is reduced by the additional days held by the agency.

Office of Management and Budget (OMB) Guidance. As required by the Prompt Payment Act, OMB provides implementing regulations in title 5, Code of Federal Regulations (CFR) Section 1315 (2002). The OMB guidance excludes all contract financing payments from the cash management requirement. Contract financing includes progress payments, performance based payments, and interim commercial financing.

DFAS Columbus and MOCAS. According to DFAS Columbus records, its Contract Pay Product Line made payments to contractors totaling \$87 billion in FY 2001. DFAS Columbus uses the Mechanization of Contract Administration Services (MOCAS) system, an integrated system used to support post-award contract administration. In addition to contract administration services, MOCAS is designed to provide financial, inventory, funding, and payment information to its various users.

Major Defense Contractors. DoD procurement records show that Lockheed Martin, Northrop Grumman, and Raytheon were the first, third, and fourth largest DoD contractors in sales to DoD in FY 2002. In FY 2002, the three contractors were awarded prime contracts collectively valued at about \$32.7 billion. Major programs developed by these contractors include the C-5 Galaxy, the F-16 Fighter, the B-2 Spirit, and the Hellfire, Tomahawk, and Patriot missiles.

Hot Lists. DFAS termed the spreadsheets it received from certain contractors “hot lists” if the spreadsheets contained invoices the contractors expected to be paid by a certain date. These spreadsheets could contain information such as the contract number, invoice number, shipment number, and payment due date. According to DFAS managers and customer service personnel, the Hot Lists were designed to allow vendors to notify DFAS personnel if there appeared to be invoices that were getting close to the payment due date that were still not ready for payment. Subsequent to the hotline allegation, DFAS Columbus changed the term “Hot List” to “Invoice Inquiry List.”

DFAS Columbus Cash Management of Invoices. DFAS Columbus personnel stated that MOCAS is designed to hold all cash managed invoices ready for payment until the twenty-third day after the receipt of the invoices. On the twenty-third day, MOCAS will release the invoice from suspension for payment. According to DFAS Columbus, there are ways to bypass the normal MOCAS systemic payment controls, and generate an early release of the cash-managed invoices. Two of the more common ways to cause an invoice to be paid early are to use the “force-thru” function in MOCAS, or to simply manually release the invoice from suspension in MOCAS.

Force-Thru Function. According to DFAS systems personnel, MOCAS is programmed to reject some invoices because they do not appear to meet all the criteria necessary for proper availability and use of funds. DFAS personnel recognize situations when these invoices could be rejected, and can manually entitle them using the force-thru function to prevent the rejection. However, when invoices are entitled in this fashion, the invoices bypass normal programmed-in edits and will be released from cash management (paid) as soon as the invoices have been “pre-validated.”¹

The force-thru function is a part of DFAS Columbus policy and should be used to process a valid invoice when the standard MOCAS payment process will reject the invoice for payment. For example, when there is insufficient unliquidated contract financing to pay an invoice because other invoices pending disbursement have already liquidated the contract financing, DFAS personnel must use the force-thru code in MOCAS to accurately process the payment. Other situations could also generate a force-thru transaction such as payment instructions provided by a contracting officer that link contract items to specific appropriations or advise that contract financing not be used to pay the invoice. These two situations differ from the standard MOCAS payment process and require manual intervention. Approval by a Division Chief is required on all force-thru transactions, and comments must be entered to explain why the payment must be forced through. An example of a force-thru comment would be “Invoice not subject to liquidation per Administrative Contracting Officer (ACO).” According to DFAS Desk Procedure 401, the force-thru function has been in place since 1996 or earlier.

Manual Release. A manual release is another method for making an early payment. According to DFAS personnel, there are several DFAS employees who have the ability to release an invoice that is ready for payment before the twenty-third day. DFAS Desk Procedure number 101 states that all requests for early releases of correctly suspended payments should be in writing, well documented, and signed by the Commander of the requesting activity, or their designee. The procedures require the contractor relations specialist to inform all contractors to go through their ACO for early release requests of properly suspended payments. A completed form DFAS-CO-FM 103, “Early Release Form,” is used and must be received by the invoice control supervisor before an invoice is released from cash management.

¹ The pre-validation process is a legal requirement and ensures that funds are available to pay the invoice. We did not audit any portion of the prevalidation process.

Objectives

The objective of the audit was to determine whether DFAS Columbus was making contract payments in accordance with applicable disbursement policy. Specifically, we determined whether DFAS Columbus was paying invoices in compliance with the cash management requirements of the Prompt Payment Act. See Appendix A for a discussion of the scope and methodology and our review of the management control program.

Early Payment of Invoices

There was insufficient evidence to substantiate the allegation that the Defense Finance and Accounting Service Columbus made early payments directly resulting from contractor-provided Hot Lists, or gave preferential treatment to three contractors. However, from January 2002 through January 2003, the Defense Finance and Accounting Service Columbus regularly paid invoices from the three contractors in the Hotline allegation, and other DoD contractors, earlier than allowed by the Prompt Payment Act. The Defense Finance and Accounting Service Columbus paid 108 judgmentally selected invoices totaling \$300 million from the three Hotline contractors, and an additional 6,691 invoices totaling \$1.3 billion to the three Hotline and other DoD contractors, more than 7 days prior to the due date. In the majority of cases, MOCAS released the funds before the twenty-third day because the invoices had to be entered using the force-thru function and bypassed the edits that would have held the funds in suspense for 23 days. Additional early payments resulted from DFAS use of a program to release canceling funds earlier than necessary; manual early release of payments; and various other reasons, such as data entry errors. As a result, the Defense Finance and Accounting Service Columbus did not effectively adhere to the cash management requirements of the Prompt Payment Act, and the early disbursements resulted in potential lost interest to the U.S. Treasury of about \$1.5 million.

DoD Prompt Payment Act Policy

The DoD Financial Management Regulation (FMR), Volume 10, chapter 7, “Prompt Payment Act,” February 1996, provides specific guidance to disbursing offices for complying with the Prompt Payment Act. The FMR directs that payments should be made in a timely manner (neither early nor late) and requires cash management of invoices.

The policy requires that payments be scheduled as close as possible to, but not later than, the discount or payment due date. The DFAS Site Director, the head of a disbursing office, or their designee has the authority to waive the cash management requirement. However, the FMR requires that early payment be the exception rather than the rule.

Evidence of Hot Lists and Preferential Treatment

There was insufficient evidence to substantiate the allegation that early payments were the result of contractor-provided Hot Lists, or that preferential treatment was given to specific contractors based on their size or political influence.

Hot Lists. DFAS Columbus did not retain specific Hot Lists related to the payments to contractors named in the hotline complaint. DFAS Columbus also

did not publish any written policy on the use of Hot Lists to facilitate invoice payments. However, MOCAS records included some evidence for four sample invoices indicating that DFAS may have given them special attention. For example, the words “Hot Hot Hot,” “High Dollar Expedite” or similar wording were written on cover sheets for these invoices. Nevertheless, because a specific Hot List was unavailable, we were not able to link the four payments to a specific hot list.

Subsequent to the hotline allegations and as a result of a DFAS Internal Review audit, DFAS Columbus renamed the term “Hot List” to “Invoice Inquiry List.” DFAS Internal Review recommended the change in terminology to avoid confusion about the purpose of the contractor lists. Invoice inquiry lists are also submitted by other large DoD contractors such as Boeing and General Dynamics.

Preferential Treatment. There was no direct evidence that DFAS Columbus personnel gave preferential treatment to the three contractor invoices over those from other contractors.

To test for preferential treatment, we compared early payment data for the three contractors named in the allegation to other contractors that received early payments from DFAS Columbus. We also compared the average days to pay contract financing payments for the three Hotline contractors versus other DoD Contractors.

We compared invoice payment dates of the three contractors named in the Hotline complaint to three other large DoD contractors (Boeing, TRW, and General Dynamics) for the same time period. The data showed that the average payment date for all cash-managed invoices for each contractor was 24 days, and early payment of invoices from these contractors ranged from 4 to 9 days. Similarly, DFAS Columbus made payments to Lockheed Martin, Northrop Grumman, and Raytheon ranging from 6 to 9 days early. Based on this analysis, there was no conclusive evidence that preferential treatment was given to the three contractors listed in the Hotline complaint over other companies that were similar in size and work.

In addition to comparing invoice payment dates of similar size contractors, we reviewed all contract financing payments of those contractors from January 1, 2002, through January 31, 2003, using contract payment data in MOCAS. Financing payments are not subject to cash management and require payment much sooner than the 30 days required for cash managed invoices. The average payment time was 10 days after receipt of invoices regardless of the contractor. Based on this analysis, there was no measurable indication that Lockheed Martin, Northrop Grumman, and Raytheon received preferential treatment for contract financing payments.

Payments Made Early

Although there was no clear evidence of preferential treatment for the contractors identified in the Hotline allegation, those contractors were paid early.

DFAS Columbus paid high-dollar invoices for Lockheed Martin, Northrop Grumman, Raytheon and other DoD contractors earlier than the window for allowable payment directed by the Prompt Payment Act, which is 7 days prior to the due date.

Judgmental Sample of Hotline Contractor Invoices. To test for early payments, we judgmentally sampled 231 invoices from Lockheed Martin, Northrop Grumman, and Raytheon valued at about \$2.2 billion that appeared to be paid early. The data were provided by DFAS Columbus. The invoices comprised about 69 percent of the total invoice amounts of all invoices that appeared early for these three contractors from January 1, 2002, through January 31, 2003.

Of the 231 invoices judgmentally selected, DFAS paid 108 invoices valued at about \$1.5 billion earlier than was required. DFAS disbursed \$300 million for these invoices.² DFAS Columbus paid the remaining 123 sample invoices in accordance with the Prompt Payment Act.

Based on the results from the sample of the three contractors mentioned in the Hotline complaint, we examined additional contractor payments by judgmentally selecting 386 invoices valued at \$1,746.8 million with disbursements of \$426.7 million. These invoices were selected from all cash managed invoices from January 1, 2002, through January 31, 2003, that had been paid using the force-thru function.

Of the 386 invoices selected, DFAS paid 266 invoices valued at \$1,475.2 million with disbursements of \$359.4 million earlier than allowable under the Prompt Payment Act.

Other Contractors Paid Early. In addition to the results of our judgmental samples, DFAS Columbus provided data that showed an additional 6,425 invoices had been forced-thru early for payment. Those invoices were valued at \$1,474.7 million and DFAS disbursed \$929.1 million of that amount early.

In total, from January 2002 through January 2003, DFAS Columbus paid 108 judgmentally selected invoices totaling \$300 million from the three Hotline contractors, and an additional 6,691 invoices totaling \$1.3 billion to the three Hotline and other DoD contractors, more than 7 days prior to the due date.

Table 1 displays this same information in a different way. Table 1 total disbursements are rounded. The table shows a summary of the early payments identified for Lockheed Martin, Raytheon, Northrop Grumman, and the remaining DoD contractors in MOCAS.

² The invoice amount is higher than the disbursed amount because DFAS had already disbursed portions of the invoice for contract financing payments.

| Table 1. Summary of Early Payments | | | |
|---|--|--|---|
| <u>Contractor</u> | <u>Number of Early Payments</u> | <u>Invoice Amounts (millions)</u> | <u>Disbursed Amount (millions)</u> |
| Lockheed Martin | 747 | \$837.3 | \$263.0 |
| Raytheon | 1,091 | \$351.6 | \$196.5 |
| Northrop Grumman | 207 | \$921.5 | \$124.4 |
| Other Contractors | 4,754 | \$2,378.7 | \$1,008.2 |
| Total Early | 6,799 | \$4,489.1 | \$1,592.0* |
| * Rounded Amount | | | |

Processing Early Payments

DoD contractors were paid early for several reasons. Sixty-two of the 108 sample early payments to the three Hotline contractors and 6,691 other contractor payments were paid early because DFAS Columbus performed a manual force-thru of the invoice. The manual force-thru resulted in about \$1.5 billion of the \$1.6 billion in early payments. DFAS Columbus paid the remaining 46 sample invoices early because of MOCAS system processes that allow early release of invoices due to canceling appropriations, manual override of system controls, and for other, as yet, unexplained reasons. See Table 2 for a breakdown of the cause for the early payments. Table 2 total disbursements are rounded.

| Table 2. Causes of Early Payments | | | |
|---|----------------------------------|---|---|
| <u>Cause</u> | <u>Number of Invoices</u> | <u>Invoice Amount (millions)</u> | <u>Disbursed Amount (millions)</u> |
| Force-Thru | 6,753 | \$3,950.1 | \$1,519.2 |
| Systems release | 4 | \$2.1 | \$0.7 |
| Manual Release with inadequate support | 5 | \$7.7 | \$3.3 |
| Inadequate explanation provided | 30 | \$524.1 | \$66.1 |
| Other | <u>7</u> | <u>\$4.6</u> | <u>\$2.9</u> |
| Total | 6,799 | \$4,488.6 | \$1,592.0* |
| * Rounded Amount | | | |

Force Thru Payments. As shown in the table, there were at least 6,753 invoices with disbursements totaling \$1.5 billion that were paid early using the force-thru function in MOCAS.

MOCAS was designed to perform an accounting adjustment to “recoup” funds that have already been paid to contractors through contract financing, such as progress payments, when a delivery is received. However, in some instances MOCAS attempts to recoup certain funds to pay an invoice that entitlement personnel determine should not be recouped. In these instances, the entitlement clerk processes a “force-thru” of the invoice and obtains the required supervisory approval as discussed in the background of this report.

The use of the force-thru function moves an invoice outside of the normal cash management edits in MOCAS and, therefore, the force-thru invoices were not queued for cash-management, and proceeded directly to disbursing after pre-validation. DFAS Columbus needed to establish controls to ensure that invoices subject to the Prompt Payment Act, that were paid using the force-thru function, were not paid earlier than allowable by the Prompt Payment Act.

Of the 6,753 force-thru invoices that DFAS Columbus paid early (see Table 2), we identified 62 through our judgmental sample of 231 invoices from the Hotline contractors, an additional 266 through our other judgmental samples of data on other large DoD contractors, and the remaining 6,425 early force-thru invoices from data provided by DFAS Columbus that we reviewed and considered to reliably represent early force-thru invoices that were processed by DFAS Columbus personnel.

Table 3 shows a breakdown of the force-thru invoices paid early by DFAS Columbus. Table 3 total disbursements are rounded.

| Table 3. Breakdown of Early Force Thru | | | |
|---|----------------------------------|---|---|
| <u>Identified Through</u> | <u>Number of Invoices</u> | <u>Invoice Amount (millions)</u> | <u>Disbursed Amount (millions)</u> |
| Hotline Judgmental Sample | 62 | \$1,000.3 | \$230.7 |
| Other Judgmental Samples | 266 | \$1,475.2 | \$359.4 |
| DFAS provided data | 6,425 | \$1,474.7 | \$929.1 |
| Total | 6,753 | \$3,950.1 | \$1,519.2* |
| * Rounded Amount | | | |

The force-thru function in MOCAS that bypasses the cash management function has been available in MOCAS for many years. We discussed the problem of early payments with DFAS Columbus systems representatives during the course of the audit. The systems representatives indicated that although the force-thru function may result in early payments to contractors, there was no systemic weakness in MOCAS because the system was performing as intended.

On September 16, 2003, and subsequent to our audit exit meeting, DFAS Columbus issued a memorandum titled "Preparation of Payment Review Checklist and Proper Use of Force-Thru Code," which cautioned that the use of the force-thru should be minimized and carefully scrutinized. This memorandum is a positive step toward raising employee awareness of the cash management issue associated with using the force-thru function, but does not preclude the need for further cash management improvements. DFAS Columbus management needs to address the systematic early payment of force-thru invoices. Specifically, MOCAS should not be programmed to automatically allow contractor payments to bypass controls that prevent payment before the twenty-third day, and DFAS Columbus management must ensure compliance with the Prompt Payment Act.

MOCAS Systems Release. We identified four early payments that were made possible by DFAS Columbus programming MOCAS to prematurely release invoices for payment if the funding appropriations are due to be canceled at year-end.

The DoD FMR Volume 10, Chapter 7, "Prompt Payment Act," states that when the payment due date falls after the appropriation cancellation date, payments are exempt from early payment rules and may be paid prior to the cancellation of the appropriation. DFAS is provided a list of the funds that will cancel at the end of the fiscal year and runs a program on September 1 that will release all invoices from cash management as soon as the invoice has been entitled and pre-validated. DFAS Columbus paid 12 of our sample items early as a result of their canceling funds policy. However, 4 of the 12 invoices were released from cash management when the payment due date would have occurred before the cancellation of the appropriations. This policy results in early payments and is not an effective use of DoD funds.

DFAS Columbus management stated that additional processing time is needed to process invoices paid with canceling funds, so that there is sufficient time to correct potential payment errors. This policy is based on the notion that payment errors are more routine than out of the ordinary. We believe that releasing payment for invoices with canceling funds up to thirty days early is unnecessary and a shorter time period allows adequate opportunities to correct errors.

Manual Release of Payments. For five invoices that were paid early, DFAS Columbus personnel manually released the payments early without following DFAS procedures. The Prompt Payment Act allows for early payment on a case-by-case basis. DFAS regulations implement this exemption by requiring an Early Release Form to be filled out and approved by the supervisor. The Early Release

Form is to be used cautiously, in cases such as financial hardship of the contractor. The standard procedure is for the Agency or contractor to contact DFAS customer service and fill out the early release form with the Administrative Contracting Officer's signature. In five instances, the Early Release Form was completed by a DFAS employee with no apparent supervisory review or adequate explanation as to the reason for the release.

Inadequate Explanation. For 30 of the 108 sample invoices from the three hotline contractors, MOCAS records did not contain, and DFAS Columbus was unable to provide, an adequate explanation of why the payment was made early. Records indicated that the 30 invoices were paid early without proper cause. DFAS Columbus assigned two employees to research the 30 invoices. After the additional research, DFAS Columbus was not able to provide any explanation as to why the payments were made early.

We asked whether these invoices were included on contractor hot lists. However, DFAS Columbus personnel said they did not maintain hot lists for these invoices and stated that they destroy contractor hot lists and invoice inquiry lists shortly after they receive them. DFAS Columbus was able to provide a contractor representative for two of the three contractors who provided additional information about the invoices. Specifically, for the 11 invoices represented, 8 had been provided on a hot list, although the name, hot list, was not used. There was no indication on the hot lists that the contractors were requesting early payment. Additionally, both of these contractor representatives stated that the invoice information was not a request for early payment or special treatment. The contractors stated that the information was provided to ensure that DFAS Columbus had received the invoices and that the MOCAS information for them was accurate. We were unable to determine whether the remaining 19 invoices were on a contractor hotlist.

During the audit, MOCAS systems personnel stated that MOCAS does not automatically release invoices so they can be paid early. According to DFAS Columbus records, as of June 23, 2003, there were 22 employees who had the necessary access to manually release payments from cash management. DFAS Desk Procedure 301 states that this type of release should only occur when the employee receives a completed Early Release Form, such as from an administrative contracting officer. However, according to DFAS systems personnel, there is no edit or control in MOCAS to prevent an early release of an invoice for payment if a completed Early Release Form is not obtained.

MOCAS data showed that 26 of the 30 invoices did not appear to be MOCAS system releases because the payment due date appeared to be properly calculated. For the remaining 4 invoices, the MOCAS information was not readily available for use in determining whether the early payment was a result of a manual or system release from cash management.

Other. DFAS Columbus paid seven sample invoices early for various other reasons. For example, various data entry errors caused six of the seven early payments that we categorized as "other" in Table 2.

Loss of Monetary Funds

The Prompt Payment Act, as implemented in 5 C.F.R. Section 1315.4 “Prompt Payment Standards and Notices to Vendors,” was legislated to ensure that contract payments would be made timely and as close to the payment due date as possible. The C.F.R. policy states that Federal agencies have the authority to make payments early but that this authority should be used cautiously while weighing the benefits of good stewardship inherent in effective cash management practices.

Because DFAS Columbus did not effectively adhere to the cash management requirements of the Prompt Payment Act, the early disbursements potentially cost the U.S. Treasury about \$1.5 million in interest. Our sample results indicate that DFAS Columbus paid 6,799 invoices, totaling \$4.5 billion with a disbursement value of about \$1.6 billion, earlier than they should have been paid. The invoices were paid outside the MOCAS internal control that stages invoices and prevents early payments to ensure compliance with the Prompt Payment Act. Based on the Treasury Current Value of Funds Rates in place from January 2002 through January 2003 when the \$1.6 billion in early payments were made, a potential loss of Federal funds of \$1.5 million occurred. We calculated the \$1.5 million loss by taking the disbursement dollar value of the invoice and multiplied the result by the current Treasury rate for the payment period. We divided by 360 days multiplied by the number of days the invoice was paid early. DFAS needs to improve procedures to prevent unnecessary and preventable costs in the future.

Cash Management of DoD Funds. The DoD FMR discourages early payments and requires that payments be made on time, not early and not late. DoD policy on early payments is designed to keep funds in Treasury longer and may reduce interest expenses on associated borrowed amounts needed to finance DoD payments.

A policy that effectively provides disbursements to DoD contractors on time, not early and not late, would prevent unnecessary interest costs to the U.S. Treasury and improve DoD compliance with the cash management requirements of the Prompt Payment Act.

In most instances of early payments, DFAS Columbus processed the invoices for payment by using the force-thru function. This function has become a normal, accepted business practice at DFAS Columbus and that results in poor cash management of DoD funds.

Recommendations, Management Comments, and Audit Response

We recommend that the Director, Defense Finance and Accounting Service Columbus, Contract Pay Services:

1. Revise the Mechanization of Contract Administration Services processing system edits related to the force-thru function to ensure invoices subject to the Prompt Payment Act provisions are held until 7 days prior to the payment due date.

Management Comments. The Director, Commercial Pay Services, concurred with the recommendation, stating that manual processes will be temporarily instituted until the MOCAS rehost is implemented. Upon implementation of the MOCAS rehost, a system change request will be submitted to ensure that all invoices are properly subjected to cash management. The Director stated that invoice reviews will include an evaluation of the use of a force-thru. The Director stated that the Contract Pay Operations Entitlement Management Control Program is being revised to include a monthly review of force-thru invoices. She also stated that the use of the Form 64, Force-thru Approval/Checklist, in conjunction with the EDM Notelog to explain why the payment must be a force-thru, will be strictly enforced.

Audit Response. The Director's comments were partially responsive. The change to MOCAS should correct the cash management issue related to early payment of invoices that are forced-thru. In addition, the interim procedures will ensure that force-thru invoices are necessary and proper. Although the Director's comments indicated that a sample would be used to ensure compliance with policy and procedures, the comments did not specifically address how the interim processes will prevent early payment of invoices that are properly forced-thru but require cash management controls. The majority of the force-thru invoices that we examined were justified and valid. However, until the MOCAS rehost is implemented, additional manual procedures are needed to ensure that the valid force-thru invoices are held until at least 7 days prior to the payment due date and not paid early. Such procedures could include revising the entitlement process to require entitlement personnel to delay processing invoices that are required to be forced-thru until approximately 7 days prior to the due date. We request that the Director reconsider her position and provide additional comments to the final report that specifically describe the manual controls that will ensure that force-thru invoices are not paid early.

2. Revise the current payment program for funds due to be canceled, so that invoices that have payment due dates within 10 working days of the fiscal year-end are not paid early.

Management Comments. The Director, Commercial Pay Services, concurred with the recommendation, stating that DFAS Columbus has instructed the Defense Enterprise Computing Center to process the cash management program approximately 10 working days prior to fiscal year end.

3. Establish controls to prevent the early release of a payment without supervisory approval and adequate supporting documentation.

Management Comments. The Director, Commercial Pay Services, concurred with the recommendation, stating that DFAS Columbus reissued the “Waiver Criteria for Early Release of Payments in Cash Management” policy in conjunction with a letter from the Director of Customer Support directing adherence to the procedural requirement for a cash management waiver. The Director also stated that the Contract Pay Operations Management Control Program is being revised to include a monthly review of invoices processed using a waiver of cash management to ensure its proper use.

Audit Response. The Director’s comments were partially responsive. Increasing awareness and using monthly reviews will ensure that proper steps are taken to process waivers of cash management rules. However, the Director’s comments did not address the early release of payments when no evidence of a waiver is present in MOCAS. We identified 30 early payments where MOCAS records were unavailable to support the reason for making the early payment. For these payments, we could not conclude whether circumstances justifying a waiver of cash management rules existed. Procedures were needed to prevent and detect whether early payments that are made without a waiver of the rules of cash management are justified. The procedures should require reviews of all early payments made by entitlement personnel that are not supported by waivers to cash management rules. These types of reviews will prevent DFAS from making early payments that lack the documentation that supports bypassing cash management controls, and will detect early payments that are made without adequate support. We request that the Director reconsider her position and provide additional comments to the final report.

Appendix A. Scope and Methodology

We obtained all MOCAS invoice payment data for Lockheed Martin, Northrop Grumman, Raytheon, TRW, General Dynamic, and Boeing from January 1, 2002, through January 31, 2003. We also obtained all MOCAS contract financing payments from January 1, 2002, through January 31, 2003. We obtained all cash-managed force-thru payments that were purportedly paid in less than 23 days after receipt of the invoices and had a field which indicated whether the payments were accompanied by MOCAS errors. For invoice payments coded as service-type (SER) invoices, we verified that MOCAS contained the proper receipt date and made adjustments if necessary. For the invoices with error codes, we adjusted the age of the invoice based on the days held, if necessary. All of the MOCAS data included contractor shipment number, invoice number, receipt and payment dates, and invoice amount. DFAS Columbus provided the disbursed amount by Accounting Classification Reference Number.

We arranged the MOCAS invoice records provided by DFAS Columbus for six large contractors into separate databases. We performed queries on the Lockheed Martin, Northrop Grumman, and Raytheon databases to judgmentally select our sample, based on invoice dollar value and age of payment. We selected 244 invoices, and determined that 13 invoices were not applicable to the cash management requirements and excluded these invoices from our results. To perform additional force-thru testing, we also selected 48 invoices from TRW, General Dynamics, and Boeing that were coded as force-thru. We determined that three invoices were not applicable to the cash management requirements, and excluded these invoices from our results.

We performed tests to verify the force-thru database for all DoD contractors provided by DFAS Columbus and excluded invoices that we had previously reviewed. Specifically, we judgmentally selected 224 service-type invoices and 97 invoices with error codes from the database of force-thru invoices to verify that they were paid early and were properly coded as a force-thru. We included the remaining force-thru invoices that DFAS Columbus provided that were not service-type or error-coded as early payments.

Calculating Interest Savings. We performed interest savings calculations by multiplying the disbursement dollar value of the invoice by the current Treasury rate for the payment period and dividing that amount by 360 days. Then we multiplied that amount by the number of days the invoices were paid before the twenty-third day.

We performed this audit from February 2003 through December 2003 in accordance with generally accepted government auditing standards.

Use of Computer-Processed Data. We relied on computer-processed data from the Mechanization of Contract Administration System (MOCAS) to determine the universe of contractor invoices, the receipt and payment dates of the invoices, and the payment mechanisms used to forward the contractor invoices to the DFAS Columbus disbursing office. Although we did not perform a formal reliability assessment of the computer-processed data, we determined that the information in

MOCAS relating to the contractor invoice receipt date and payment dates, and the mechanisms used by entitlement personnel to process payments, generally agreed with the scanned images of the invoices. We did not find a significant number of data entry or other errors that precluded use of the computer-processed data to meet the audit objectives, or that changed the conclusions in this report.

Use of Technical Assistance. We received assistance from the Quantitative Methods Division in the Office of the Inspector General of the Department of Defense. Specifically, Quantitative Methods Division helped us determine judgmental sample sizes, made suggestions to verify whether other DoD contractors besides the three Hotline contractors had early payments that were generated by a force-thru in MOCAS, and assisted in calculating potential lost interest to the U.S. Treasury from the DFAS Columbus early payment of invoices.

General Accounting Office High-Risk Area. The General Accounting Office has identified several high-risk areas in DoD. This report provides coverage of the Defense Financial Management high-risk area.

Management Control Program Review

DoD Directive 5010.38, “Management Control (MC) Program,” August 26, 1996, and DoD Instruction 5010.40, “Management Control (MC) Program Procedures,” August 28, 1996, require DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of the Review of the Management Control Program. We reviewed the adequacy of DFAS Contract Pay Product Line management controls for processing contractor invoices, and determined whether these controls were adequate to prevent early payments and preferential treatment to certain contractors. Specifically, we reviewed DFAS Contract Pay Product Line management controls for cash-managed invoices that are paid using the force-thru function and other manual processes that could result in early payment to contractors. We also reviewed management’s self-evaluation applicable to those controls.

Adequacy of Management Controls. We identified material management control weaknesses for the DFAS Contract Pay Product Line as defined by DoD Instruction 5010.40. DFAS Contract Pay Product Line management controls for cash-managed force-thru payments and other manual payment processes were not adequate to ensure payments were paid in accordance with the Prompt Payment Act. Recommendations 1, 2, and 3, if implemented, will improve the DFAS Contract Pay Product Line compliance with the Prompt Payment Act, and will prevent unnecessary and preventable interest costs to the U.S. Treasury. We calculated these costs to be \$1.5 million for the time period from January 1, 2002, through January 31, 2003. A copy of the report will be provided to the senior official responsible for management controls within the DFAS Contract Pay Product Line.

Adequacy of Management's Self-Evaluation. DFAS Contract Pay Product Line officials identified operations support and entitlement operations as assessable units. However, prevention of early payments was not directly addressed in either of the assessable unit self-evaluations. As part of its assessable unit self-evaluation, DFAS Columbus should include a control test to determine whether early payments are being prevented.

Prior Coverage

No prior coverage has been conducted on early payments as prohibited by the Prompt Payment Act during the last 5 years.

Appendix B. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)/Chief Financial Officer
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Naval Inspector General

Department of the Air Force

Auditor General, Department of the Air Force

Other Defense Organizations

Director, Defense Finance and Accounting Service
Director, Commercial Pay Services

Non-Defense Federal Organization

Office of Management and Budget

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Reform
House Subcommittee on Government Efficiency and Financial Management, Committee on Government Reform
House Subcommittee on National Security, Emerging Threats, and International Relations, Committee on Government Reform
House Subcommittee on Technology, Information Policy, Intergovernmental Relations, and the Census, Committee on Government Reform

Defense Finance and Accounting Service Comments



DEFENSE FINANCE AND ACCOUNTING SERVICE
COLUMBUS
P.O. BOX 182317
COLUMBUS, OHIO 43218-2317



FEB 13 2004

DFAS-BA/CC

MEMORANDUM FOR DIRECTOR, FINANCE AND ACCOUNTING DIRECTORATE,
OFFICE OF THE INSPECTOR GENERAL, DEPARTMENT OF
DEFENSE

SUBJECT: IG Draft Report, Project No. D2003FJ-0062, "Report on Early Payment of Invoices by
the Defense Finance and Accounting Service Columbus," Dated December 18, 2003

In response to the DoD IG draft report dated December 18, 2003, subject as above,
management comments for Recommendations 1 through 3 and the Management Control
Weakness are provided.

If you have any further questions, please contact Ms. Simone Lordier, DFAS-BAQA/CC,
at DSN 869-6800 or 614-693-6800.

Sally A. Smith
Director, Commercial Pay Services

Attachment:
As stated

www.dfas.mil
Your Financial Partner @ Work

**DFAS Management Comments Regarding
IG Draft Report "Early Payment of Invoices by the Defense Finance and
Accounting Service Columbus," Dated December 18, 2003**

Recommendation 1: Revise the Mechanization of Contract Administration Services processing system edits related to the force-thru function to ensure invoices subject to the Prompt Payment Act provisions are held until 7 days prior to payment.

Management Comments: Concur. A system change to Mechanization of Contract Administration Services (MOCAS) is not feasible at this time due to system design limitations. The use of a force-thru bypasses all system edits, including cash management, to process the payment. Under the current MOCAS structure, it is not possible to design or change MOCAS to by-pass only specific edits while adhering to others. Upon implementation of the MOCAS rehost, a System Change Request will be submitted to ensure all invoices are properly subjected to cash management.

Until a systemic solution can be implemented, manual processes will be instituted as compensating controls. Beginning February 9, 2004, the Entitlement Front End Analysis invoice reviews will include an evaluation of the use of a force-thru. The evaluation will include the validation of the propriety of the force-thru, sufficiency of the explanation in the Electronic Data Management (EDM) Notelog, and inclusion of a prepared Form 64 force-thru Approval/Checklist to the EDM case. Invoices identified as not requiring a force-thru or deficient in support or explanation will be returned to the Entitlement Supervisor for revision.

In addition, the Contract Pay Operations Entitlement Management Control Program is being revised to include a monthly review of invoices that were processed using the force-thru option. Beginning February 2004, the Analysis and Support Branch will provide a monthly data extract of all invoices that were processed using a force-thru to Contract Pay Operations. Contract Pay Entitlement will research a sample of this population on a monthly basis to ensure validation of approval, sufficiency of EDM Notelog comments, adherence to policies and procedures as well as propriety of usage.

Also, the addition of the Form 64 force-thru Approval/Checklist to the EDM workflow for Contract Pay Voucher Examiners and inclusion as part of the EDM case for the invoice is pending. In the interim, the Form 64 will be completed and manually scanned into EDM for incorporation in the case. The use of the Form 64, in conjunction with EDM Notelog to explain why the payment must be forced-thru, will be strictly enforced. The Contract Pay Entitlement Financial Analysts will review and approve invoices forced-thru using the Entitlement Automation System module.

Estimated Completion Date: Compensating controls have been implemented. The estimated completion date for revisions of MOCAS is to be determined.

Recommendation 2: Revise the current payment program for funds due to be canceled, so that invoices that have payment due dates within 10 working days of the fiscal year-end are not paid early.

Management Comments: Concur. At Defense Finance and Accounting Service (DFAS) instruction, Defense Enterprise Computing Center will process the Cash Management Program approximately 10 working days prior to fiscal year end.

Estimated Completion Date: This recommendation is considered closed. No further action required.

Recommendation 3: Establish controls to prevent the early release of a payment without supervisory approval and adequate supporting documentation.

Management Comments: Concur. MOCAS system access for early release of payments from cash management is a two step process. The Waiver of Cash Management is processed by the Tier II Technician and subsequently approved by a lead, Supervisor, Financial Specialist or Division Chief. Approval consists of validation of appropriate supporting documentation and propriety of approval for the request.

DFAS Columbus Policy No. 0700-02-0002 dated September 11, 2002, "Waiver Criteria for Early Release of Payments in Cash Management," was reissued in conjunction with a letter from the Director of Customer Support directing adherence to Desk Procedure 101, Procedure 2 on January 14, 2004. This portion of the Desk Procedure indicates the Administrative Contracting Officer must sign the written request from the contractor prior to DFAS taking action to release the payment.

Furthermore, the Contract Pay Operations Entitlement Management Control Program is being revised to include a monthly review of invoices that were processed using a Waiver of Cash Management. Contract Pay Entitlement will review these invoices to ensure proper use of the waiver, adherence to policies and appropriate supporting documentation.

Estimated Completion Date: March 5, 2004.

Material Weakness: We identified material management control weaknesses for the DFAS Contract Pay Product Line as defined by Department of Defense Instruction 5010.40. DFAS Contract Pay Product Line management controls for cash-managed force-thru payments and other manual payment processes were not adequate to ensure payments were paid in accordance with the Prompt Payment Act.

Management Comments: Concur. The Management Control Program (MCP) for Entitlement is being revised to include a monthly review of invoices processed using the force-thru option

in MOCAS as well as invoices released early from cash management by a Waiver of Cash Management. The revised MCP will include a monthly review of all invoices that were processed using a force-thru to ensure validation of approval, sufficiency of EDM Notelog comments, adherence to policies and procedures as well as propriety of usage. In addition, it will mandate a monthly review of invoices that were processed using a Waiver of Cash Management to ensure proper use of the waiver, adherence to policies and propriety of supporting documentation.

Estimated Completion Date: March 5, 2004.

Team Members

The Defense Financial Auditing Service Directorate, Office of the Deputy Inspector General for Auditing of the Department of Defense prepared this report. Personnel of the Office of the Inspector General of the Department of Defense who contributed to the report are listed below.

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